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SUBJECT: Tokyo-based Economists give DUSTR Bhatia mixed outlook on prospects for reform

¶1. (SBU) Summary: Leading economists told Deputy USTR Karan Bhatia and E/B Assistant Secretary Daniel Sullivan on December 5 that they were somewhat pessimistic about prospects for continued economic reform under PM Abe. Richard Jerram, Chief Economist at Macquarie Securities, criticized the Japanese government, Bank of Japan, and Japanese managers for poor economic stewardship. University of Tokyo Economics Professor Motoshige Ito was more optimistic and focused on signs that Japanese consumers, younger Japanese, and even Japanese farmers were becoming more open to reform and change. Toyo University Economics Professor Toru Nakakita, who co-chairs the Asia Gateway Strategy Conference with Prof. Ito, described their goal as bringing together various strands of Japan's Asia economic policy with a focus on pushing for more Free Trade Agreements (FTAs) in the region.

Prospects for Reform under PM Abe

¶2. (SBU) Both Japanese economists agreed that Abe will find it harder than his predecessor, ex-PM Koizumi, to sell reform politically and that Abe seemed to be buying some peace before the election with less public emphasis on reform.

¶3. (SBU) Richard Jerram posited that many of Japan's leaders have concluded that the country's economic crisis is over, that things are back to "normal," freeing them to focus on other priorities such as foreign and security policy and giving jobs to friends. Economic policy direction has been returned to the bureaucrats, in his view. However, if Japan really wants to push growth, tax reform would be one of the single most useful reforms the government could carry out. Jerram pointed out that there are no tax IDs in Japan and that there are estimates that as much as seventy per cent of Japanese companies do not pay any taxes. Tax evasion is particularly widespread among the self-employed in Japan.

¶4. (SBU) Ito believes the public has fully embraced changes that were resisted 20 years ago such as changes in the large retail store law. After recalling several other reforms that now go unquestioned, Ito attributed it to the transformation of Japanese society, including: a) generation change, b) behavior and lifestyle change, and c) attitude change. Younger Japanese are changing their society and may be able to change Japanese corporate culture in the future. Still, Ito felt that

entrepreneurship and market mechanisms need to be nurtured further.

Plenty of Market worries

15. (SBU) In answer to a question about what most worries investors in Japan, Jerram listed market worries about: what happens when the current expansion is over; when the population begins to decline in earnest; and when the Japanese government hits a fiscal crunch. Jerram saw problems at the Japanese central bank which is worried about inflation and a possible bubble that no one else sees. He characterized the Bank of Japan's attitude as one of knowing better than the government, promising to end the party if the government becomes speculative or irrational. Jerram also criticized recent government moves on consumer finance which unnecessarily restrain the market, and the proposed rules on triangular mergers which will reduce foreign direct investment (FDI) into Japan. Another concern is the perception that Japanese managers are still not making decisions based only on economic factors to maximize profits. Because of that, there is less trust among investors in Japan that the market knows best, according to Jerram. Ito asserted that the largest risks to the Japanese economy are still a recession in the U.S. and a significant decline in the value of the U.S. dollar.

Attitudes towards FDI need to change

16. (SBU) Attitudes towards FDI in Japan, especially among big businesses seem to be stuck in the 1930s, Ito asserted. This mercantilist approach creates a vicious

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circle with little investment coming in and, as a result, attitudes towards FDI are also slow to change. Nakakita agreed that many people, including in the business community, have outsized fears of hostile takeovers, which the media have stoked by playing up negative stories. However, some attitudes are beginning to change, Professor Ito stressed. As an example he pointed out that ten years ago, his students were warned that going to work for a foreign company like Goldman Sachs would be a "career-killer." Nowadays many of his students apply for jobs at Goldman Sachs, but even some of the best cannot get jobs there because of the competition.

Asia Gateway/ Regional Relations

17. (SBU) Nakakita and Ito, who are both members of the Asia Gateway Strategy Project lead by PM Abe's chief Economic Advisor Takumi Nemoto, described the project as a "window for policy," designed to bring together the disparate elements of Japan's economic policy towards Asia. Free Trade Agreements (FTAs) will be an important part of that agenda as Japan tries to harness some of Asia's fast growth for its own benefit. Ito gave as one example the opening up of Japan's economy through the division of labor (with lower labor cost countries) to give Japan higher growth. All of the economists agreed that better relations with China are one of the keys to Japan's economic future and hoped that Abe understood the importance of getting that relationship back on track.

Agriculture a stumbling block

18. (SBU) While all of the economists agreed that Japan's ability to negotiate FTAs is constrained because agriculture is considered untouchable, Professor Ito claimed that there are signs of change which make him

optimistic. Ito believes that there is a change in the attitudes of farmers and recalled a conversation with an official from the Agriculture Ministry (MAFF) who said that they do not want to be seen as obstacles to progress on FTAs and are trying to portray themselves as neutral, not in opposition. Ito said it is too soon to say that Japan is ready to negotiate on agriculture issues, but that change is already started.

¶9. (SBU) Many aging Japanese farmers are holding onto land which they expect will only increase in value, making it difficult for younger, more productive farmers to acquire land, according to Ito. He also believed that the government provides too many benefits and services to aging farmers and should turn its support now to the productive and potentially competitive farmers.

Globalization leads to Income Gap

¶10. (SBU) The group also discussed how globalization and the resulting widening gap between rich and poor in Japan are increasingly visible in Japan. The Japanese economists agreed globalization has helped those who are highly skilled and part of the "knowledge culture," while increasing the gap between rural and city residents, particularly those living in booming Tokyo. Many who lost jobs or were never able to find permanent employment during the decade of recession simply gave up. They also supported PM Abe's idea that it is important to give these people a second chance, through education and training. Japanese people do not enjoy the same opportunity to recover from bankruptcy or losing a job, for example, as people in the U.S., where failure has less stigma and Americans believe it is OK to try and fail and then try again.

¶11. (U) Economists participating in the lunch:

Motoshige ITO, Professor, Faculty of Economics,
University of Tokyo:
Toru NAKAKITA, Professor of Economics at Toyo University
USG Participants:
Richard JERRAM, Chief Economist at Macquarie Securities
Ltd

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USG participants:

DUSTR Karan Bhatia
A/S Daniel Sullivan
DAUSTR Michael Beeman
EMIN Hans Klemm
Econoff Marilyn Ereshefsky (notetaker)

DONOVAN